

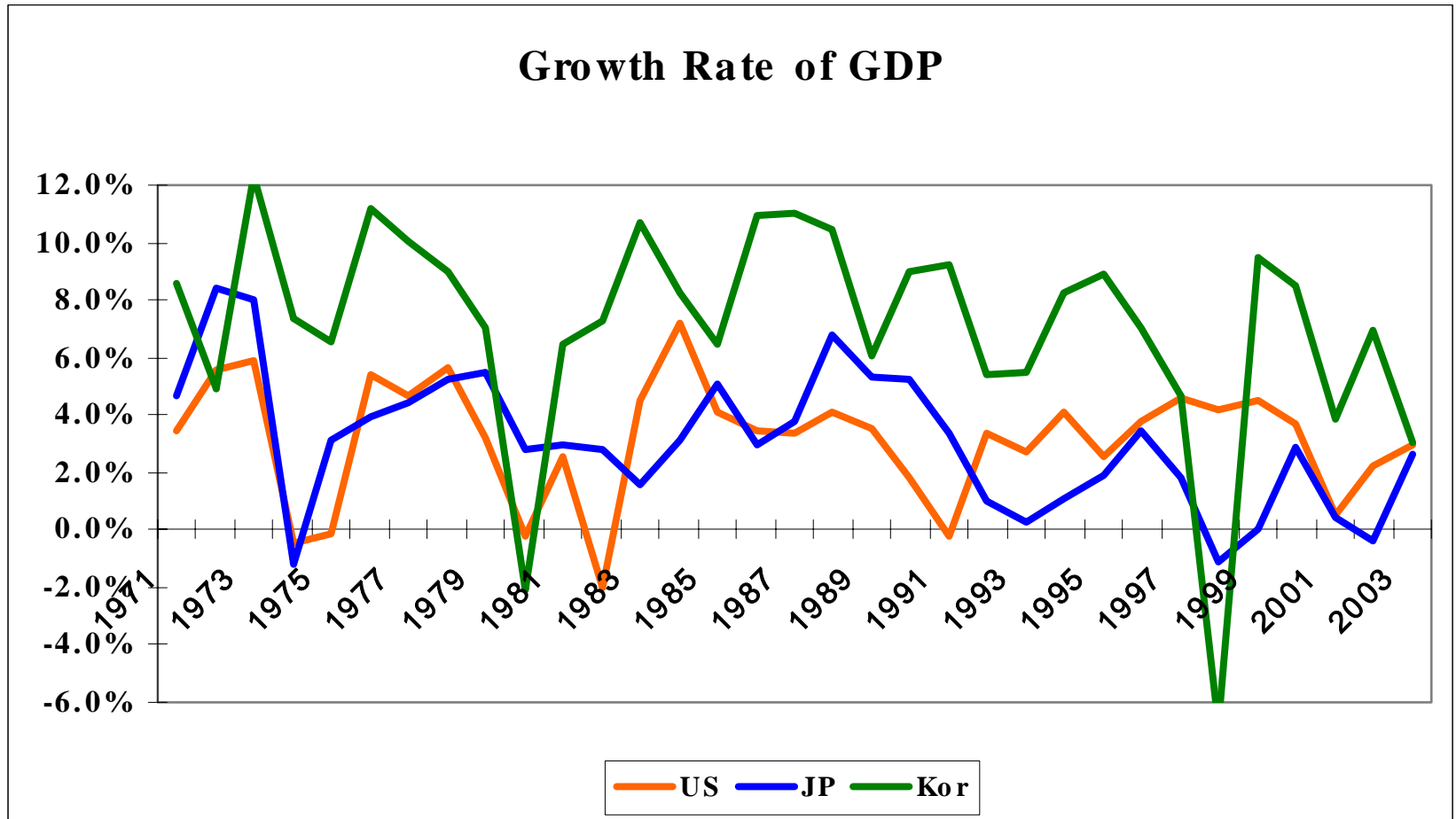
# Building Competitiveness Through External Economic Relations

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# Outline

- Myths and Truths of U.S. Economic Resurgence
- Korea's Core Challenges
- The Role of External Economic Relations in Meeting Those Challenges
- The U.S.-Korea Economic Agenda

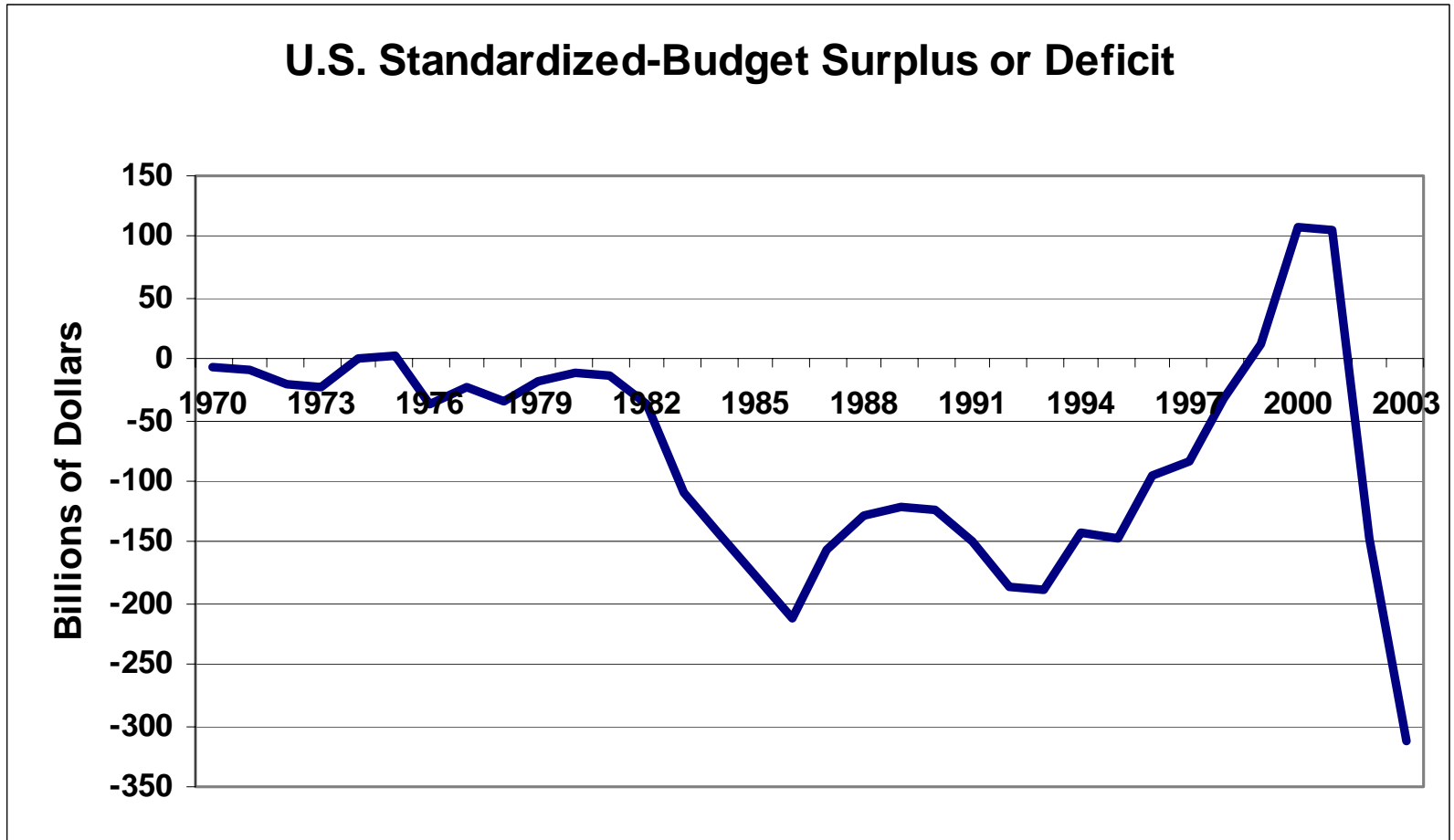
# The Big Surprise: America Comes Back



# Myths of the U.S. Recovery

- “Give All the Credit to Maynard Keynes”
  - U.S. bounce back in 1980’s mainly due to fiscal expansion
  - Increase in Cold War spending stimulating high-tech industries in California, Massachusetts
- → Problem with the Myth:
  - Growth continued under Clinton/Rubin fiscal contraction
  - Unrelated high growth in IT, telecom, pharmaceuticals

# U.S. Fiscal Position in Recent Decades



# Myths of the U.S. Recovery

- “President Reagan Beat the Unions”
  - Some commentators put huge emphasis on lower rates of union participation
  - Broke the back of air traffic controllers
  - Slowed wage growth
- → Problem with the Myth:
  - Lower unionization due mainly to technology changes, higher labor participation rate
  - Wage competitiveness not a fundamental source of U.S. competitiveness, U.S. continued to lose high-wage, low-productivity industries (steel, textiles)

# Truths of the U.S. Recovery

## 1. Technology Change

- IT Revolution, with U.S. at the forefront, leading to huge gains in productivity growth

## 2. Revolution in Business Financing

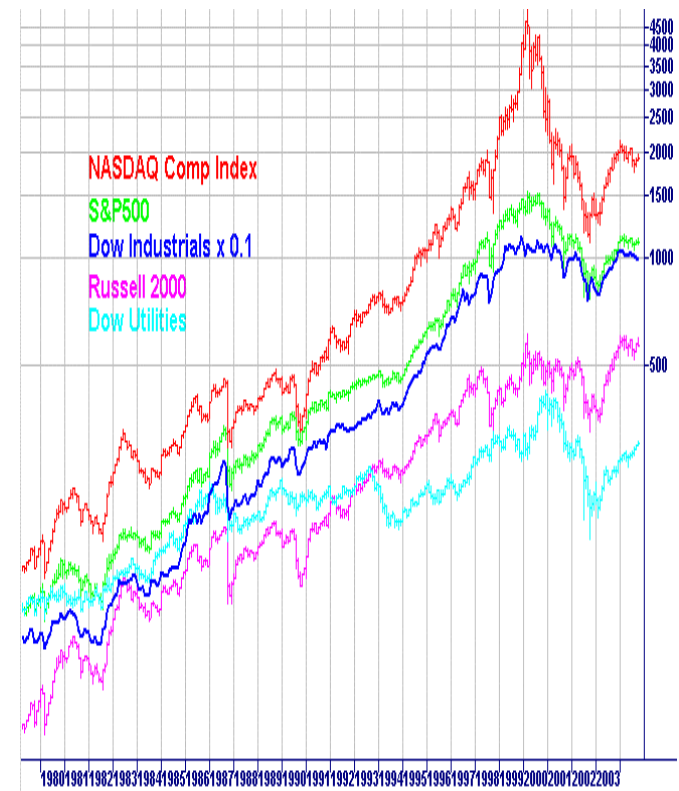
- Whole new system of financing and corporate governance

## 3. High Openness to External “Help”

- Open markets maximize competition
- Magnet for foreign direct investment reinforces productivity gains

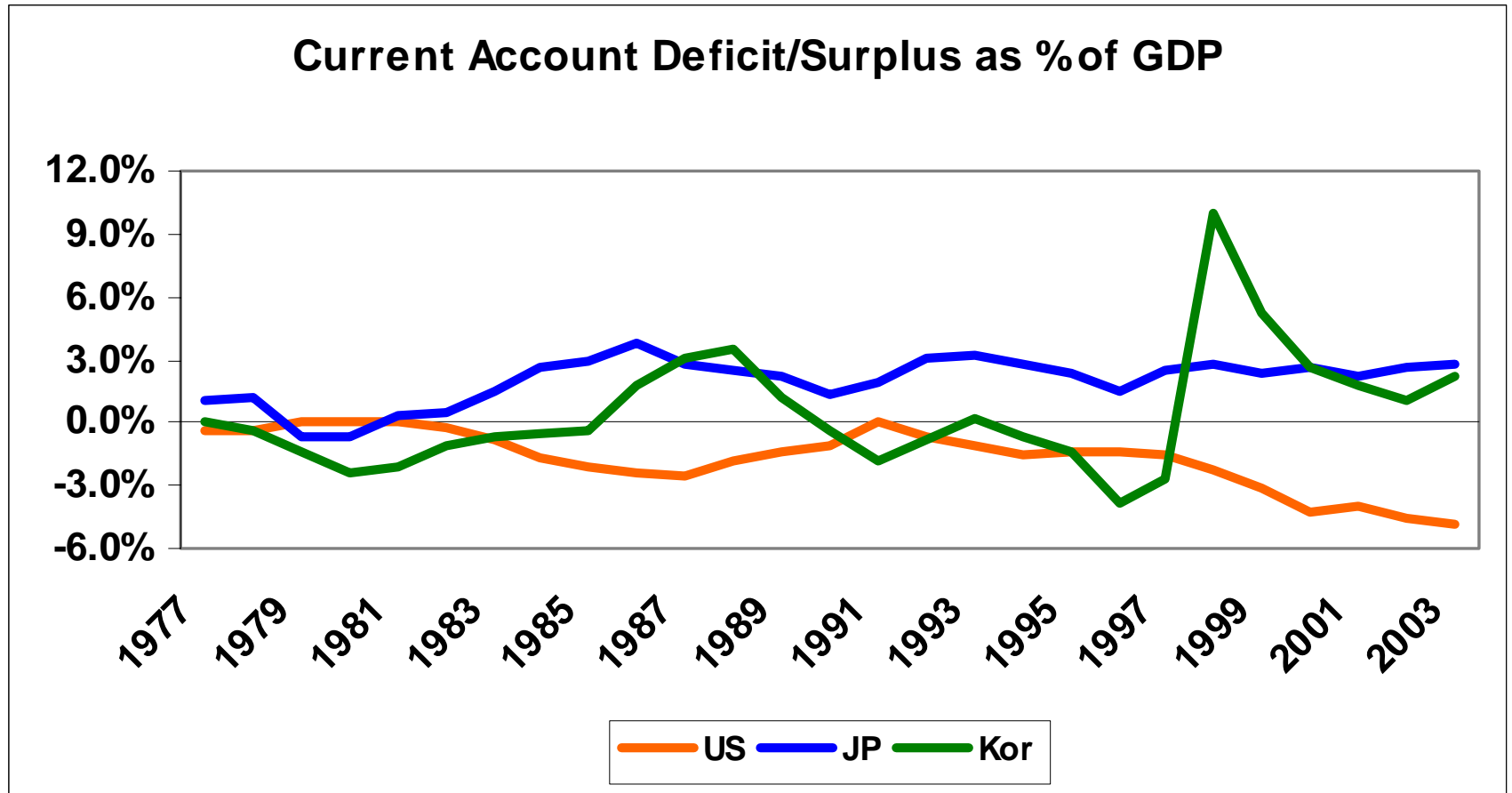
# Business Financing Revolution

- Switch from loan financing to equity financing
- Market-based corporate governance
- “Das Kapital” Socialism: Broader indirect ownership of “means of production”
- → Causes:
  - Financial sector deregulation
  - Accounting Standards
  - IT changes

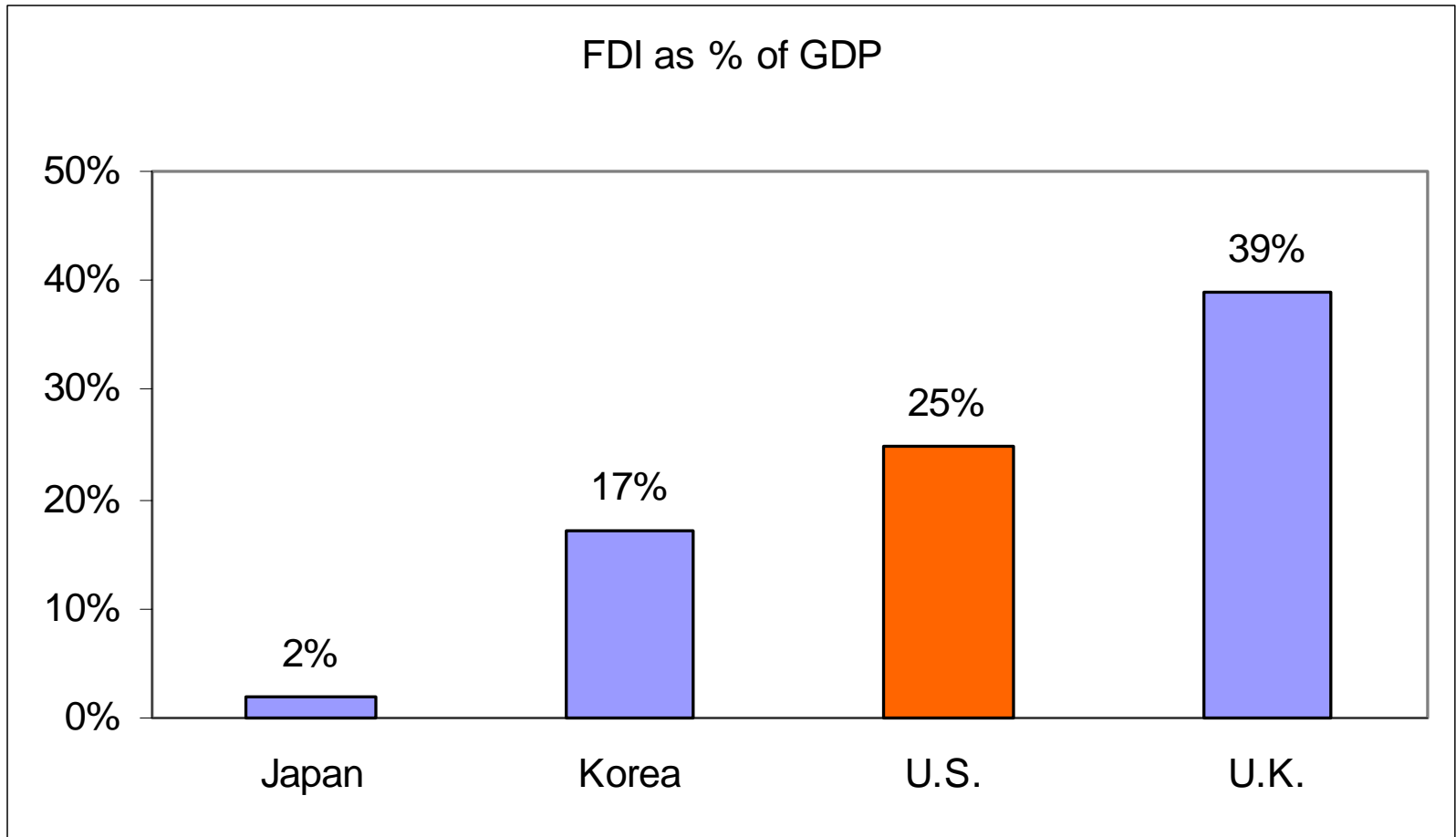




# Openness to External “Help”



# Large, Non-Trade-Dependent Economy with High Rate of FDI



# Korea's Core Challenges

## 1. The Aging Problem

- Fastest fertility rate decline in any major country in human history
- Huge impact on social expenditure, fiscal position, labor force, industrial capability and political outlook -- not to mention its culture and society.
- By the time you all are ready to retire, Korea will be a very different place.
- Basic growth theory says sustained growth harder to achieve when the labor force is not growing.
- Social costs could become prohibitively expensive without growth.

### → Key Solution:

- The most important thing is **productivity growth**.
- Produce more, especially in services, using fewer people.
- Key is Korea's ability to attract and introduce new technologies, both "hard technologies" and "soft technologies" such as new business management practices.

### → External Openness Can Be A Key Source of Productivity Growth

# Korea's Core Challenges

## 2. "Bifurcation" -- or splitting in two -- of the Korean Economy

- Happening on both the business front and the labor front
- Privileged few seeking excessive benefits for themselves, at the expense of the efficiency and growth potential of the broader economy.
- Business sector:
  - Small group of technologically-advanced firms with capability to reach world markets enjoying immense export boom, financed by a narrow but vibrant corporate bond market.
  - Less technologically-advanced, more domestically-oriented smaller firms struggling to stay alive, amid shrinking consumer activity and a possible contraction of bank financing.
  - Larger, stronger firms making it harder to bridge this gap by fighting corporate governance reforms and greater management accountability
  - Harder for smaller or start-up firms to use direct financing to take advantage of new opportunities in services sectors, other areas with a high potential for growth.

# Korea's Core Challenges

- Labor sector:
  - Unionized workers taking advantage of link to profitable firms to demand rights, benefits and job security, plus wage growth > growth in productivity
  - Non-union workers at smaller firms, and irregular and temporary workers, seeing only slow improvements, or even declines, in their real incomes.
  - Spiral: Concentration of national wage bill makes profitable firms more reluctant to hire permanent staff, more likely to sub-contract or use temp staff → "bifurcation" deepens.

## → Key Solution:

- The most important thing is **financial sector reform**.
- Labor policy reform – especially labor law -- also important, but new systems of financing and corporate governance for SME's create positive solution.
- Development of venture capital and start-ups.

## → External Openness Can Be Key Source of Financial Sector Reform

# Foreign Investors' "Wish List"

- Transparent, predictable and open regulatory process
- Open attitudes to M&A as well as greenfield FDI
- Improved corporate governance and accounting
- Reduced government interference in the market, including in setting of technology standards
- Better protection of intellectual property rights
- More flexibility in the hiring and firing of workers
- Constructive relations between management and workers

# Foreign Investors and Traders'

## “Goodie Bag”

- Introduction of foreign capital and technology – Citibank's spark in banking, Carrefour spurs change in the retail sector
- Potential for similar investments in areas such as telecommunications services, education or health to accelerate reform and productivity growth
- Open markets to trade and investment bring in both new "hard technologies" and "soft technologies" -- reforms in corporate governance and labor practices --needed to bridge "bifurcation" problem
- Challenge domestic capital and labor to do a better job
- Fills gaps in the economy

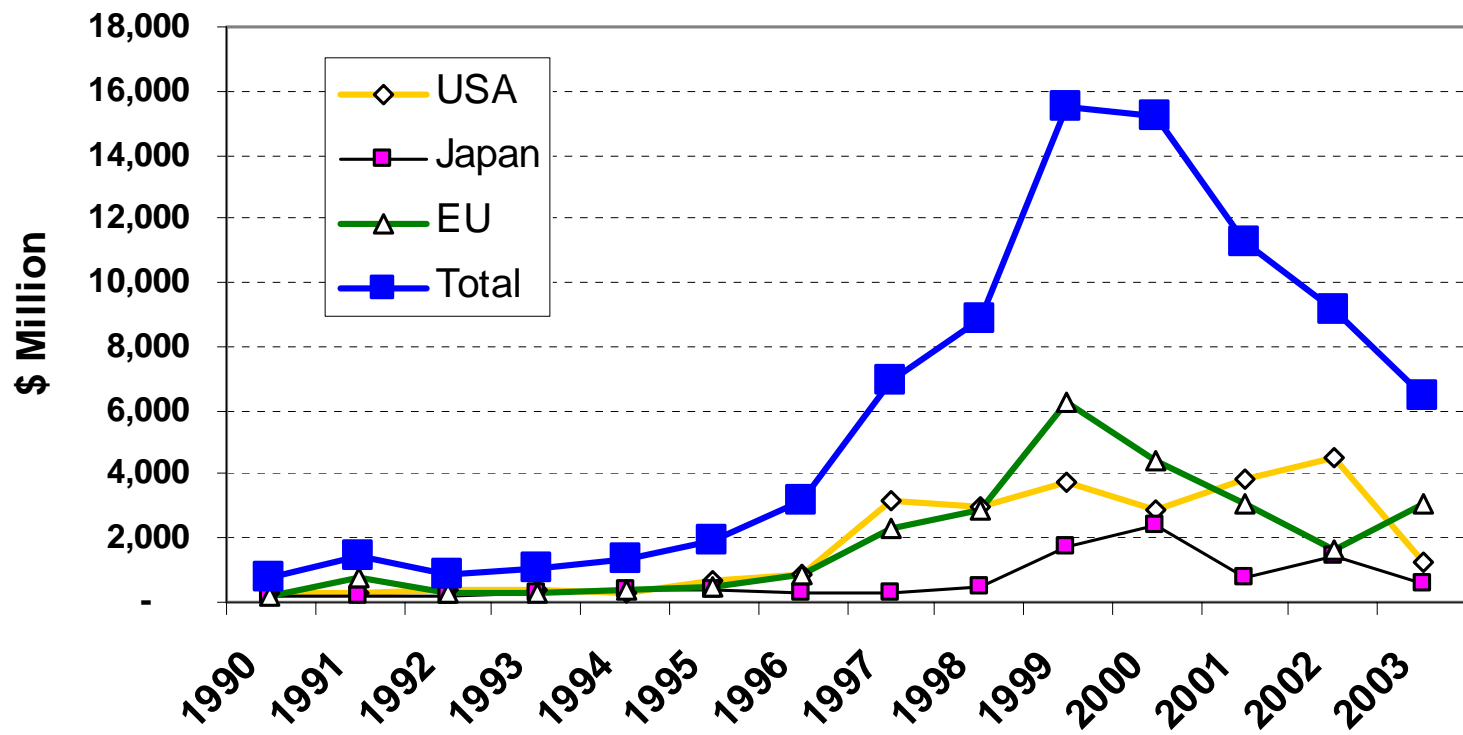
# U.S.-Korea Economic Agenda

- Likely FTA agenda, beyond agriculture:
  - competition policy enforcement;
  - IPR protection
  - pharmaceuticals pricing;
  - setting of technology standards;
  - investment limits and cultural quotas;
  - access for services industry firms and professionals.
- Current Key Sectoral Issues:
  - Intellectual Property Rights
  - Telecommunications regulation
  - Pharmaceuticals regulation
  - Access to autos market
  - Access to agricultural markets

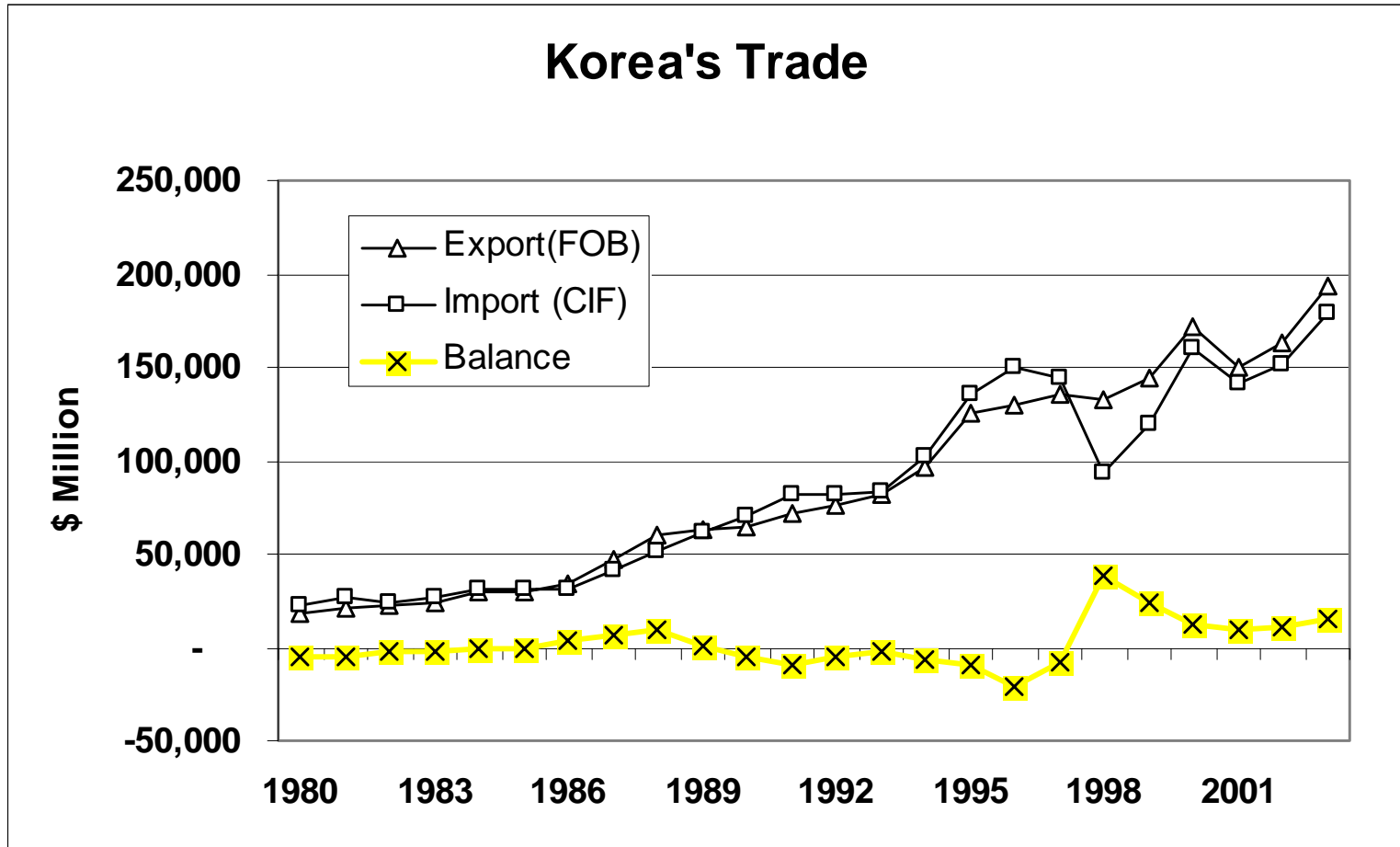


# Inward Investment from Advanced Competitors

Korea's Inward Direct Investment -- > Peaked After Crisis

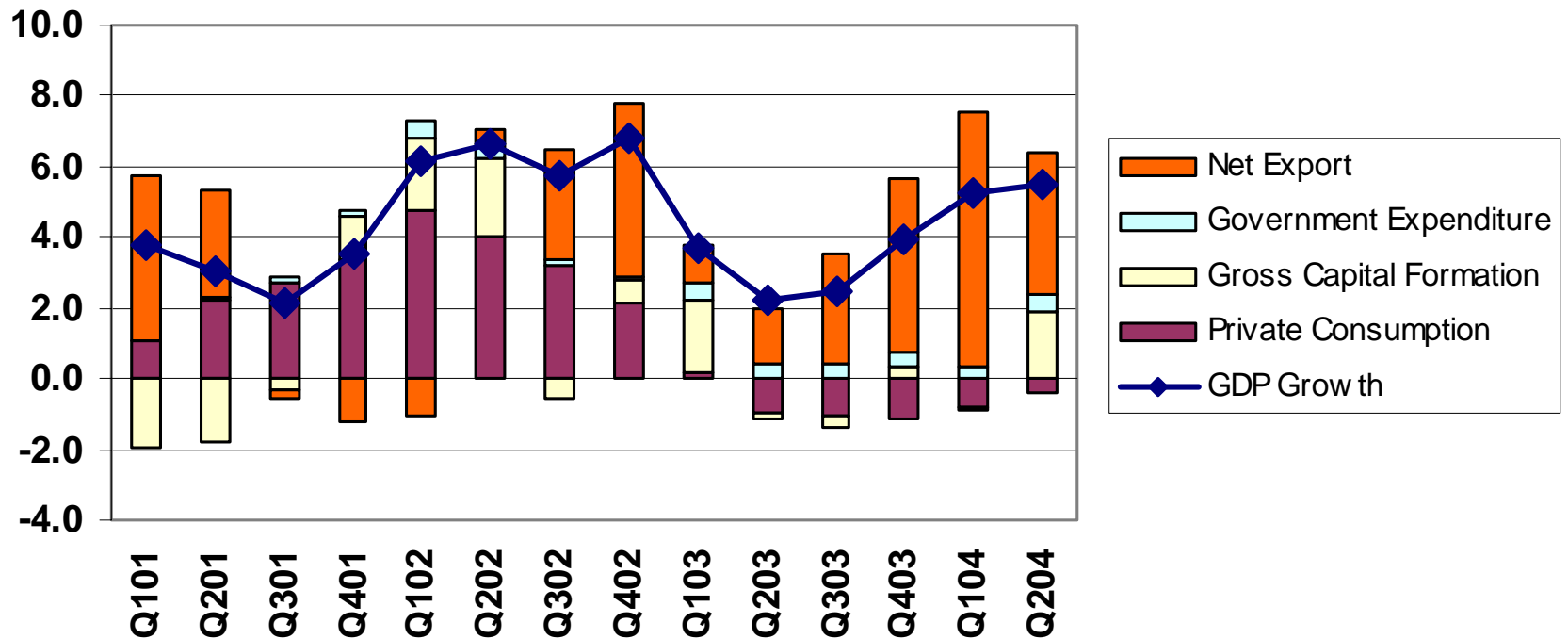


# Korea's Foreign Trade Generally Balanced



# Reliance on Net Exports for Growth

Contributions to GDP Growth (YoY, %)



# Korea Often Runs Trade Surplus with United States

